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C O N F I D E N T I A L SECTION 01 OF 02 ALMATY 000886

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SUBJECT: CHEVRON'S EURASIA MANAGER OFFERS INSIGHT INTO CPC
DEADLOCK

REF: A. MOSCOW 1931

[1](#)B. ALMATY 4264

Classified By: Ambassador John Ordway for reasons 1.4(B) and (D)

[1](#)1. (C) Summary. Guy Hollingsworth, Chevron's Eurasia Business Unit President, told Ambassador on March 2 that he believes that Russia is conditioning CPC pipeline expansion on the construction of a Burgas-Alexandroupolis (B-A) bypass in part because both Energy Minister Viktor Khristenko and Transneft President Simon Weinstock have personal financial stakes in the construction and operation of a B-A bypass, which would lessen tanker traffic through the Bosphorus Straits. Hollingsworth echoed CPC General Director Ian McDonald (Ref A) in saying that Chevron wasn't opposed in principle to a bypass; in fact, a bypass was critical, if only as insurance against the risk of a Bosphorus closure.

[1](#)2. (C) Summary (continued): Hollingsworth updated the Ambassador on several Tengiz oil field issues. Chevron and the GOK had finally reached a compromise on the GOK's long-standing demand that Tengiz supply the Atyrau refinery with discounted Tengiz crude; the two sides had agreed on the supply of lower-cost Karachaganak crude instead. Hollingsworth told the Ambassador that he was balking at paying the GOK its Tengiz royalties in-kind (as the GOK was asking,) due to Chevron's concern GOK intended to ship the oil to Iran. Finally, Hollingsworth commented that, in his opinion, Timur Kulibayev, the President's son-in-law, would soon re-emerge on the public scene with more power than he had previously held as KazMunaiGaz (KMG) Vice-President. End Summary.

Explaining Russian Motivation in CPC Negotiations

[1](#)3. (C) Hollingsworth told the Ambassador that he believed Russia's recent conditioning of CPC pipeline expansion on the construction of a B-A bypass could be explained by the fact that both Khristenko and Weinstock had personal financial stakes in the construction and operation of a B-A bypass. "Weinstock wants to run the bypass," he said, "and Khristenko is sitting on expansion to force the bypass." Hollingsworth said that he had been relieved to learn of Khristenko's and Weinstock's personal stakes in the B-A project, because the information implied that Russia did not have deeper, more intransigent objections to CPC expansion. "I don't care what they do with their deals," he concluded -- it is good to finally understand what is motivating the Russians. Chevron, Hollingsworth said, would go along with a bypass "just as insurance" against a shut-down of the Bosphorus straits. The difficulty with moving forward with the B-A option, he mused, was Turkish opposition.

14. (C) Hollingsworth noted that, even if CPC expansion got underway soon, it wouldn't be complete until 2009. With Tengiz production due to double in Summer 2007, Chevron would be forced to ship Tengiz volumes by rail and vessel to Baku. (See Ref B for details of this plan.) The timing of Tengiz expansion had slipped, he admitted, in part because of difficulties in obtaining work permits for expatriates. (According to its founding contracts, TengizChevroil (TCO) is not required to obtain work permits for its expatriate employees. As recently as February, however, the GOK had temporarily blocked the entrance of 30 employees. TCO appealed to Foreign Minister Tokayev to resolve the issue.) The expansion project had also experienced cost overruns, growing from \$4.1 to 5.5 billion -- which was "nothing," Hollingsworth laughed, in comparison to Kashagan. (cost update on Kashagan will be sent via Septel.)

15. (C) Hollingsworth reported that TCO had finally reached a compromise on the long-standing GOK demand that TCO deliver crude to the Atyrau refinery at below-market cost. The GOK had upgraded the refinery, Hollingsworth explained, under the assumption that it would be able to obtain crude at 40% of international prices. TCO, in turn, had held fast to the terms of its founding contract, which granted TCO the right to sell any oil it produced at market prices. As a compromise, Hollingsworth explained, Chevron had offered to supply the refinery with Karachaganak crude -- much of which "is sold at Orenburg for Atyrau prices anyway." Last week, Hollingsworth said, KMG had finally agreed to accept delivery of Karachaganak crude.

ALMATY 00000886 002 OF 002

16. (C) Hollingsworth briefed the Ambassador on an emerging issue of concern to TCO. According to the terms of the Tengiz contract, the GOK can take its royalty payments either in dollars or in-kind. Hollingsworth explained that the GOK had recently asked to be paid in-kind, with oil delivered to Atyrau -- leading Chevron to suspect that the GOK intended to ship it to Iran. Chevron was thus in a difficult position. In 1996, Hollingsworth recounted, the GOK had wanted to ship its in-kind TCO oil to Iran, and, after a long process, "the USG signed off." Now, Hollingsworth said, Chevron was seeking assurances from the GOK that the TCO royalty oil would not be shipped to Iran. However, Hollingsworth added, if the GOK forced the issue, Chevron would likely be found in breach of contract if it refused. Ambassador offered USG assistance in resolving the issue with the GOK. "Our lawyers are getting together on the issue," Hollingsworth concluded, leaving open the possibility that Chevron would request USG assistance in the future.

Timur Kulibayev: Consolidating Power?

17. (C) Hollingsworth remarked that, in his opinion, presidential son-in-law Timur Kulibayev would soon re-emerge on the public scene with even more influence than he had possessed prior to his October resignation as KMG Vice President. Hollingsworth said that Nazarbayev had asked Kulibayev to form an association ("KazEnergy") representing the "big players" in the energy field. The association would determine "how to solve key energy issues as a group" -- for example, how to overcome Kazakhstan's shortage of skilled workers. Furthermore, Hollingsworth added, Kulibayev would soon be announced as the Vice-President of the new state holding company, Samryk. (Note: On February 24 an assistant to Samryk's president, Sauat Mynbayev, confirmed to Energy Officer that Kulibayev would, in fact, be appointed as Samryk VP. End Note) The Ambassador commented that, given that one of the presumed objectives of forming Samryk was to prepare state companies for foreign IPOs, insiders (like Kulibayev) would be in a good position to get wealthy. Hollingsworth

concluded the topic with a political prediction: "Nazarbayev and Kulibayev are consolidating power," he said. "Kulibayev will be the next president."

18. (C) Comment: Russia's conditioning of CPC expansion on a B-A bypass is justification enough, in our view, for the USG to "take sides" on the bypass issue and push for the B-A route. If, as we believe, oil volumes will eventually justify the construction of both Bosphorus bypasses, we might skirt our political problem by quietly telling the Turks that, once B-A gets built, we will throw our weight behind a Samsun-Ceyhan bypass as well. In recent days, we've had two area oil managers voice their concern about the vulnerability of the Bosphorus and the potentially serious consequences of even a short-term shutdown of the Straits (Shell's concerns will be provided via Septel.). If, as it appears, there are willing private partners for a B-A deal, it may make sense for the USG to weigh-in and try to move the deal forward.
End comment.
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